

OPEN MEETING ITEM



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COMMISSIONERS
JEFF HATCH-MILLER - Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

ORIGINAL



ARIZONA CORPORATION COMMISSION

Executive Secretary

22

DATE: March 16, 2005

DOCKET NO: T-01051B-03-0454 et al.

TO ALL PARTIES: T-00000D-00-0672

Enclosed please find the recommendation of Administrative Law Judge Jane Rodda. The recommendation has been filed in the form of an Opinion and Order on:

QWEST CORPORATION

(EMERGENCY MOTION TO SUSPEND INFLATION MINUS PRODUCTIVITY FACTOR ADJUSTMENT)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by **4:00 p.m.** on or before:

MARCH 25, 2005

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Open Meeting to be held on:

TO BE DETERMINED

For more information, you may contact Docket Control at (602)542-3477 or the Hearing Division at (602)542-4250. For more information about the Open Meeting, contact the Executive Secretary's Office at (602) 542-3931.

Arizona Corporation Commission
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1 **THE ARIZONA CORPORATION COMMISSION**

2 COMMISSIONERS

3 JEFF HATCH-MILLER, Chairman
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5 MARC SPITZER
6 MIKE GLEASON
7 KRISTIN K. MAYES

8 IN THE MATTER OF QWEST CORPORATION'S
9 FILING OF RENEWED PRICE REGULATION
10 PLAN.

DOCKET NO. T-01051B-03-0454

11 IN THE MATTER OF THE INVESTIGATION OF
12 THE COST OF TELECOMMUNICATIONS
13 ACCESS.

DOCKET NO. T-00000D-00-0672

DECISION NO. _____

14 ORDER

15 **BY THE COMMISSION:**

16 In Decision No. 63487 (March 30, 2001), the Arizona Corporation Commission approved a
17 Settlement Agreement which adopted a Price Cap Plan for Qwest Corporation ("Qwest"). The Price
18 Cap Plan, which had an initial term of three years, provides *inter alia*, that Basket 1 services are
19 capped and subject to an annual rate adjustment determined by an "Inflation minus Productivity"
20 indexing mechanism. Under that mechanism when productivity exceeds inflation, rates for Basket 1
21 services decrease effective April 1 of the following year.

22 On July 1, 2003, Qwest filed its Renewed Price Regulation Plan ("Renewed Plan") pursuant
23 to the provisions of the Settlement Agreement approved in Decision No. 63487.¹

24 By Procedural Order dated November 17, 2003, the Commission determined that Phase I of
25 the Access Charge Docket, which addresses Qwest's access charges, should be considered in
26 conjunction with the Renewed Plan.²

27 ¹ Docket No. T-01051B-03-0454 which is currently pending before us.

28 ² On February 1, 2005, Qwest filed a notice in the docket that requested Commission Staff to schedule a series of
settlement discussions. At a February 2, 2005 Procedural Conference, the Administrative Law Judge suspended the
procedural schedule to allow the parties to engage in settlement discussions. During a March 3, 2005 Procedural
Conference, the parties reported they were continuing to engage in settlement discussions.

1 On February 10, 2004, in response to a Qwest Motion to Clarify, Or In the Alternative, To
 2 Terminate Price Cap Plan, the Commission issued Decision No. 66772. In its Motion, Qwest had
 3 requested that the Commission clarify that after the expiration of the initial term of the Price Cap Plan
 4 on March 30, 2004, that: 1) no further productivity adjustment for Basket 1 Services would be made
 5 after March 30, 2004; 2) no further annual reduction in the level of access charges under the
 6 Settlement Agreement and the Price Cap Plan would be made after April 1, 2004; and 3) the
 7 procedures for changes in Qwest's rates and charges, including the hard caps imposed on the specific
 8 Basket 1 Services, would continue to apply until superceded by a revised plan approved by the
 9 Commission or a Commission order setting new rates and charges for Qwest.

10 In Decision No. 66772 the Commission found that pursuant to the Continuation Clause in the
 11 Price Cap Plan, the Plan's terms and conditions, including the productivity adjustment, continue in
 12 effect until the Commission modifies or terminates the Plan. The Commission found that Qwest
 13 must make the adjustment for the third year of the Plan effective April 1, 2004, and that the
 14 productivity adjustment remains in place pending Commission action on a new Plan.³

15 In Decision No. 67047 (June 18, 2004), the Commission addressed a Qwest Motion for
 16 Reconsideration of Decision No. 66772 and a Qwest Motion to Revise Productivity Factor. In
 17 Decision No. 67047, the Commission found that with respect to the productivity adjustment for
 18 Basket 1, Decision No. 66772 should be affirmed, and the adjustment for the third year of the Plan
 19 should be made on April 1, 2004. In addition, the Commission held:

20 Further adjustments after April 1, 2004, would be governed by the
 21 Continuation Clause of the Agreement and Basket 1 adjustments
 22 would remain in effect until the Commission approves a new or
 revised Plan.⁴

23 Qwest appealed both Decision Nos. 66772 and 67047, which appeals are currently pending
 24 before the Court of Appeals.

25 On February 3, 2005, Qwest filed an Emergency Motion to Suspend the Inflation Minus
 26 Productivity Factor Adjustment. In its current Motion, Qwest requests that the Commission suspend

27 _____
 28 ³ Decision No. 66772 at 10.

⁴ Decision No. 67047 at 6-7.

1 the application of the productivity adjustment that would be required on April 1, 2005 under the
2 terms of Decision Nos. 66772 and 67047. Qwest states that if required to make the adjustment, its
3 annual revenues would be reduced by \$12 million annually.

4 The Residential Utility Consumer Office ("RUCO") filed a Response to Qwest's Motion on
5 February 8, 2005.

6 Commission Utility Division Staff ("Staff") filed a Response to the Motion on February 22,
7 2005.

8 Qwest filed a Reply on March 1, 2005.

9 Pursuant to Procedural Order dated February 16, 2005, oral argument on Qwest's Motion was
10 held on March 3, 2005, at the Commission's offices in Phoenix, Arizona.

11 Qwest argues that if it is required to make the April 1, 2005 adjustment, it would jeopardize
12 the settlement discussions that are currently on-going concerning Qwest's Renewed Plan. Qwest
13 believes that an automatic reduction is not supported by the evidence in this case, as all testimony has
14 been filed and no party is recommending a revenue reduction. Furthermore, Qwest argues that any
15 rate reduction is very likely to be reversed in several months when the Commission ultimately
16 approves a new plan and the resulting "yo-yo" effect on rates may be confusing for consumers,
17 expensive for the Company to administer, and bad public policy. Qwest asserts that the Commission
18 can suspend any further Basket 1 reduction until it issues its final decision concerning modification,
19 amendment or termination of the Price Cap Plan and can then determine whether any further
20 adjustment or true-up will be necessary.

21 RUCO opposes Qwest's Motion and requests that the Commission deny it. RUCO argues
22 that suspending the April 1 adjustment would undermine the Commission's Decisions that confirm
23 the adjustment is legally required. According to RUCO, the Commission has twice rejected Qwest's
24 argument that claims of its under-earning justify the termination of the adjustment. RUCO also
25 argues that the Commission cannot modify the existing rate structure prior to complying with the
26 Arizona Constitution's requirements to find fair value prior to adopting new rates. To date, RUCO
27 asserts, although pre-filed testimony from all parties indicates that under traditional rate of return
28 analysis, Qwest is under-earning, it is still premature for the Commission to reach a conclusion prior

1 to a hearing on the evidence. If the Commission were to suspend the adjustment and not order a true-
2 up relating back to April 1, 2005, to give effect to the adjustment when it ultimately considers the
3 Renewed Plan, RUCO argues it would be engaging in impermissible retroactive rate making.

4 RUCO also asserts that the Commission has twice rejected Qwest's argument that requiring it
5 to make the adjustment would result in "yo-yo" rates that would confuse consumers. RUCO urges
6 the Commission to reject this argument again. RUCO claims that upon making the April 1
7 adjustment, Qwest will be permitted to determine which services in Basket 1 will have their prices
8 decreased, and later, if the Commission adopts an order in the Renewed Plan Docket modifying the
9 price cap plan that allows Qwest to increase prices on certain Basket 1 services, Qwest will be
10 permitted to determine which Basket 1 services will have their prices raised in conformance with the
11 Order.

12 Staff supports the suspension of the April 1, 2005 adjustment as long as the pending
13 consolidated appeals of Decision Nos. 66772 and 67047 are suspended for the same period of time.
14 Staff notes that it does not support the termination of the adjustment. Staff states that while it agrees
15 with many of RUCO's arguments in opposition to the Motion, Staff does not believe those arguments
16 are applicable to consideration of a suspension rather than a termination of the adjustment. Staff
17 agrees that termination of the adjustment, which is an integral part of the Plan, could violate Scates.⁵
18 Staff believes, however, that temporary suspension of the adjustment does not raise the same
19 implications under Scates and that the Commission has the flexibility to temporarily suspend the
20 adjustment pending the outcome of the docket considering the Renewed Plan. Staff believes that
21 suspension is appropriate based upon the fact that settlement discussions are underway and the
22 likelihood that any settlement reached between the parties would be a comprehensive settlement
23 which addresses both the April 1, 2005, adjustment as well as the consolidated appeal now pending in
24 the Arizona Court of Appeals. Staff's support for the suspension is conditioned upon Qwest agreeing
25 to suspend the procedural schedule of the consolidated appeal of Decisions 66772 and 67042.⁶ Staff
26 states the consolidated appeal could result in the reversal of the most recent reduction made April 1,

27 ⁵ Scates v. Arizona Corporation Commission, 118 Ariz. 531, 578 P.2d 612 (App. 1978).

28 ⁶ At the March 3, 2005 Procedural Conference, Staff provided a copy of a Court of Appeals Order dated February 24, 2005, suspending the appeal pursuant to the stipulation of the parties.

1 2004. Staff believes that suspension of the consolidated appeal maintains the status quo during
2 settlement discussion and litigation of the case, if necessary.

3 In response, Qwest argues that preserving the status quo without prejudicing any party will
4 allow the parties to move forward with productive settlement negotiations. Qwest states that because
5 it is not requesting termination of the adjustment, whether the parties are able to resolve the docket
6 through settlement or a fully litigated hearing, the Commission can then address the value, if any, of
7 continued application of the adjustment (on April 1, 2005 and in the future) on a permanent basis, and
8 after considering all of the evidence. Further, Qwest argues, as all parties' pre-filed testimony
9 indicates that Qwest's current rates produce a revenue requirement deficiency, further rate reductions
10 on April 1, 2005 serve no useful purpose and would be illegal and confiscatory. Qwest claims that
11 the transcript of the Commission's June 9, 2004 Special Open Meeting (at which time the
12 Commission considered Decision No. 67047) shows that in the event the docket was not resolved
13 prior to April 1, 2005, the Commission expressed concerns that it did not want to limit its ability to
14 consider the issue of whether the April 1, 2005 adjustment was appropriate.

15 We agree with RUCO, and deny Qwest's Motion. It is clear based on the terms of the current
16 Price Cap Plan, and our holdings in Decision Nos. 66772 and 67047 that unless we approve a new
17 Plan or terminated the current Plan, Qwest must make the April 1, 2005 productivity adjustment.
18 Public service corporations must charge the rates that are approved by the Commission. Any
19 suspension of the productivity adjustment cannot change those rates, or affect the utility's collection
20 of those amounts, because to do so would be retroactive ratemaking. The Commission cannot
21 suspend the April 1, 2005 rate adjustment without also requiring a true-up of the value of the
22 adjustment. We cannot modify current rates based on some of the parties' expectations of what may
23 happen in the future.

24 We can see however, that adjusting rates for basic services downward now as a result of the
25 productivity adjustment, and then adjusting them again in the opposite direction in the near future as
26 a result of final rates being set in the Renewed Plan, could cause consumer confusion. Consequently,
27 although we deny Qwest's Motion, we will allow Qwest the option to defer implementing the April
28 1, 2005, rate adjustment until new rates under the Renewed Plan go into effect, as long as Qwest

1 deposits the equivalent amount of the reduction into an interest bearing account, with the intention
 2 that ratepayers will receive the full benefit of the reduction when final rates are set. Thus, Qwest will
 3 have the option of implementing the April 1, 2005, productivity adjustment within 60 days of the
 4 effective date of this Order with the adjustment relating back to April 1, 2005, or deferring the
 5 adjustment until final rates are set in this docket with a true-up of the full amount of the reduction
 6 being credited to ratepayers.

7 Our Decision denying Qwest's Motion is motivated solely by a desire to avoid consumer
 8 confusion and unnecessarily complicating the administration of rates. Qwest's claim that it is under-
 9 earning under traditional rate of return analysis has no bearing on our Decision.

10 Furthermore, our holding herein is based upon the terms of the Price Cap Plan and our
 11 constitutional obligation not to modify rates absent a finding of fair value. In no way does our
 12 conclusion indicate one way or the other how the Commission will decide the issue of whether there
 13 should be a productivity adjustment when we consider Qwest's Renewed Plan currently before us.

14 * * * * *

15 Having considered the entire record herein and being fully advised in the premises, the
 16 Commission finds, concludes, and orders that:

17 **FINDINGS OF FACT**

18 1. In Decision No. 63487 (March 30, 2001), the Commission approved a Settlement
 19 Agreement in Qwest's then pending rate case which adopted a Price Cap Plan for Qwest.

20 2. On July 1, 2003, Qwest filed its Renewed Price Regulation Plan pursuant to the
 21 provisions of the Settlement Agreement approved in Decision No. 63487.

22 3. By Procedural Order dated November 17, 2003, the Commission determined that
 23 Phase I of the Access Charge Docket, which addresses Qwest's access charges, should be considered
 24 in conjunction with the Renewed Plan.

25 4. In Decision No. 66772 the Commission found that under the terms of the Price Cap
 26 Plan approved in Decision No. 63487, the terms and conditions, including the productivity
 27 adjustment, continue in effect until the Commission modifies or terminates the Plan. The
 28 Commission found that Qwest must make the adjustment for the third year of the Plan effective April

1 1, 2004, and that the productivity adjustment remains in place pending Commission action on a new
2 Plan.

3 5. In Decision No. 67047, the Commission found that with respect to the productivity
4 adjustment for Basket 1, Decision No. 66772 should be affirmed, and thus the adjustment for the
5 third year of the Plan should be made on April 1, 2004. In addition, the Commission held "Further
6 adjustments after April 1, 2004, would be governed by the Continuation Clause of the Agreement and
7 Basket 1 adjustments would remain in effect until the Commission approves a new or revised Plan."

8 6. Qwest appealed both Decision Nos. 66772 and 67047, which appeals are currently
9 pending before the Court of Appeals.

10 7. On February 3, 2005, Qwest filed an Emergency Motion to Suspend the Inflation
11 Minus Productivity Factor Adjustment. In its current Motion Qwest requests that the Commission
12 suspend the application of the productivity adjustment that is required on April 1, 2005 under the
13 terms of Decision Nos. 66772 and 67047.

14 8. Qwest states that if required to make the adjustment, its annual revenues would be
15 reduced by \$12 million annually.

16 9. RUCO filed a Response to Qwest's Motion on February 8, 2005.

17 10. Staff filed a Response to the Motion on February 22, 2005.

18 11. Qwest filed a Reply on March 1, 2005.

19 12. Pursuant to Procedural Order dated February 16, 2005, oral argument on Qwest's
20 Motion was held on March 3, 2005, at the Commission's offices in Phoenix, Arizona.

21 13. Pursuant to the Stipulation of the parties, the Arizona Court of Appeals entered an
22 Order that suspends the procedural schedule for Qwest's appeal of Decisions Nos. 66772 and 67047.

23 14. The productivity adjustment required to be made on April 1, 2005 under the terms of
24 Qwest's current Price Cap Plan is an integral part of the rates we approved in Decision No. 63487.

25 15. We reaffirm our findings and conclusions in Decision Nos. 66772 and 67047.
26 Pursuant to the terms of the Price Cap Plan we approved in Decision No. 63487, the obligation to
27 make the productivity adjustment on Basket 1 Services continues until the Commission approves new
28 rates or terminates the Plan.

16. Evidence presented concerning whether Qwest would be under-earning under traditional rate of return regulation has not yet been admitted or subjected to cross examination. Thus, it is premature to state that Qwest is under-earning or to make a determination as to the effect on rates.

17. There may be consumer confusion if Qwest is required to make the April 1, 2005 productivity adjustment and then has to adjust rates again several months later to give effect to a final Commission Order on its Renewed Plan.

18. It is in the public interest to allow Qwest to defer the implementation of the April 1, 2005 productivity adjustment until final rates are set in the current docket, as long as ratepayers receive the full benefit of the adjustment as if it had been made April 1, 2005.

19. If Qwest elects to defer implementation of the adjustment, ratepayers would be protected by having Qwest deposit the value of the reduced rates into an interest-bearing escrow account.

20. Qwest has the burden of demonstrating that the terms of any Renewed Plan or other form of rate regulation that may ultimately be approved, whether produced by settlement or through litigation, include credit for the full value of the April 1, 2005 productivity adjustment being given to ratepayers.

CONCLUSIONS OF LAW

1. Qwest is a public service corporation within the meaning of the Arizona Constitution, Article XV, and under Arizona Revised Statutes, Title 40, generally.

2. The Commission has jurisdiction over Qwest and the subject matter of Qwest's Motion.

3. Pursuant to Arizona Constitution Article 15, Section 14, the Commission must make a determination of fair value when it approves the renewal, modification or termination of the Price Cap Plan.

4. Suspending the April 1, 2005 productivity adjustment, without requiring that ratepayers ultimately receive the full benefit of the adjustment would violate the prohibition on retroactive ratemaking.

1 5. It is in the public interest to deny Qwest's Motion.

2 6. In order to avoid unnecessary consumer confusion, allowing Qwest the option to defer
3 the April 1, 2005 productivity adjustment, while depositing the revenues it would forgo from the
4 reduction in an interest bearing account, is in the public interest.

5 **ORDER**

6 IT IS THEREFORE ORDERED that Qwest Corporation's Emergency Motion to Suspend the
7 Productivity Adjustment to Basket 1 required on April 1, 2005, is denied.

8 IT IS FURTHER ORDERED that Qwest Corporation may defer the adjustment pending the
9 approval of new rates in the Renewed Plan currently before us as long as Qwest Corporation deposits
10 in a segregated interest-bearing account, sums equivalent to the revenue it would not receive if the
11 adjustment had been made effective April 1, 2005.

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1 IT IS FURTHER ORDERED that Qwest shall demonstrate that final rates approved in this
2 docket result in ratepayers receiving the full value of the April 1, 2005 productivity adjustment as if it
3 had been effective April 1, 2005.

4 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

5 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.
6
7

8 CHAIRMAN

COMMISSIONER

COMMISSIONER

11
12 COMMISSIONER

COMMISSIONER

13 IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive
14 Secretary of the Arizona Corporation Commission, have
15 hereunto set my hand and caused the official seal of the
16 Commission to be affixed at the Capitol, in the City of Phoenix,
17 this ____ day of _____, 2005.

18 BRIAN C. McNEIL
EXECUTIVE SECRETARY

19 DISSENT _____
20

21 DISSENT _____
22

23 JR:mj
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26
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QWEST CORPORATION

DOCKET NO.:

T-01051B-03-0454

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